

**COMMONWEALTH OF MASSACHUSETTS
BEFORE THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

WESTERN MASSACHUSETTS ELECTRIC COMPANY

D.T.E. 03-__

TESTIMONY OF RANDY A. SHOOP

ON BEHALF OF

WESTERN MASSACHUSETTS ELECTRIC COMPANY

AUGUST 2003

1 **I. INTRODUCTION**

2 **Q. Please state your name and company affiliation.**

3 A. My name is Randy A. Shoop. I am Assistant Treasurer - Finance of Northeast
4 Utilities (“NU”) and other system companies, including Western Massachusetts Electric
5 Company (“WMECO” or the “Company”). I am providing this testimony on behalf of
6 WMECO. My business address is 107 Selden Street, Berlin, Connecticut.

7

8 **Q. Are you the same Randy A. Shoop that testified in D.T.E. 02-49?**

9 A. Yes.

10

11 **Q. What are your responsibilities with respect to WMECO?**

12 A. My responsibilities are those I identified in D.T.E. 02-49. I am responsible for
13 raising the capital necessary to meet WMECO’s long-term and short-term financing
14 requirements, including the issuance of electric rate reduction bonds, first mortgage bonds,
15 pollution control revenue bonds, notes, lease obligations, preferred equity, common equity
16 and short-term bank notes.

17

18 **Q. Have you previously testified in utility regulatory proceedings?**

19 A. Yes. Apart from testifying in D.T.E. 02-49, I have testified on behalf of WMECO
20 before the Department of Telecommunications and Energy (“Department”) regarding the
21 issuance of debt securities, most recently in D.T.E. 00-40, WMECO’s securitization
22 proceeding. I have also testified on behalf of other NU companies in Connecticut and
23 New Hampshire.

1 **Q. What is the purpose of your testimony?**

2 A. The purpose of my testimony is to support WMECO's request to issue long-term debt
3 securities for the financing of WMECO's prior spent nuclear fuel ("PSNF") obligations
4 incurred in connection with WMECO's prior partial ownership of the Millstone nuclear
5 generating stations ("Millstone") in Waterford, Connecticut, as described below. I will
6 also support WMECO's request that the Department find it to be in the public interest to
7 exempt WMECO from the requirements of M.G.L. c. 164 §§ 15 and 15A in connection
8 with the issuance of the debt for purposes of financing the PSNF obligations.

9

10 **II. DESCRIPTION OF WMECO'S PSNF OBLIGATIONS AND THE NEED**
11 **TO FINANCE THESE OBLIGATIONS.**

12 **Q. Please describe WMECO's PSNF obligations.**

13 A. Under the Nuclear Waste Policy Act of 1982, WMECO (along with other owners
14 of nuclear generating stations) is required to pay the U.S. Department of Energy ("DOE")
15 for the disposal of spent nuclear fuel and high-level radioactive waste. The DOE is
16 responsible for the selection and development of repositories for, and the disposal of, spent
17 nuclear fuel and high-level radioactive waste. For nuclear fuel used to generate electricity
18 prior to April 7, 1983, an accrual of approximately \$48.5 million has been recorded on
19 WMECO's books for the spent fuel liability relating to its ownership of Millstone ("PSNF
20 liability") and payment must be made to the DOE prior to the first delivery of such prior
21 spent fuel to the DOE. The DOE has not yet finalized its plans for the disposal of spent

1 nuclear fuel and accordingly has not yet required shipment of such fuel or payment of such
2 PSNF liability.

3

4 **Q. How has the sale of WMECO's interest in Millstone affected the PSNF**
5 **liability?**

6 A. In March 2001, as a result of the sale by WMECO of its interest in
7 Millstone to a subsidiary of Dominion Resources, Inc. ("DRI"), DRI assumed WMECO's
8 PSNF liability. The DOE consented to this assumption, so WMECO is no longer directly
9 obligated to the DOE for the PSNF liability. However, under the terms of the purchase
10 and sale agreement between WMECO (and the other joint owners) and DRI, WMECO is
11 required to reimburse DRI for WMECO's share of PSNF liabilities required to be paid by
12 DRI to the DOE at the time the DOE requests such payment. As a result, WMECO still
13 maintains an amount equal to the PSNF liability on its books, although the liability is now
14 to DRI and not to the DOE.

15

16 **Q. Has the nature of WMECO's PSNF liability changed since your prior**
17 **testimony in D.T.E. 02-49?**

18 A. No. The nature of the liability has not changed in any respect. Of course, the
19 amount of the liability continues to accrue.

20

21 **Q. What is the current amount of the PSNF liability?**

22 A. The PSNF liability represents a fixed obligation that continues to accrue interest at

1 the 3-month treasury bill yield until payment is required to be made. As indicated above,
2 the current liability including accrued interest, as of June 30, 2003 is approximately \$48.5
3 million, all of which has been or will be included in customers' rates. Furthermore,
4 customers' rates will continue to reflect accrued interest at the 3-month treasury bill yield
5 until payment is required to be made to DRI.

6
7 **Q. What are the benefits to WMECO of financing the PSNF liability?**

8 A. Financing the PSNF liability provides WMECO primarily with two benefits. First,
9 WMECO believes it is desirable to settle the PSNF liability at this time as it no longer
10 actively participates in the nuclear energy industry. With the sale of its ownership of
11 Millstone, WMECO is no longer involved in the power generating industry. Second, the
12 issuance of the debt will also allow WMECO to better align its rate-making capitalization
13 with capitalization that determines its credit quality, as measured by credit rating agencies.
14 These are the same benefits I testified to in D.T.E. 02-49. Mr. Cahoon's testimony in this
15 proceeding provides additional information on these benefits.

16
17 **Q. Please describe how the rate-making capitalization and rating-agency
18 capitalization are currently misaligned.**

19 A. As I testified in D.T.E. 02-49, for rate making purposes the PSNF liability is not
20 included as debt in calculating capitalization. For rating-agency purposes, however, the
21 PSNF liability is included as debt. The different manners in which the PSNF liability is
22 treated results in an inappropriate capitalization ratio for WMECO for rate-making

1 purposes. After giving effect to the estimated \$55 Million issuance of the long-term debt
2 approved by the Department in D.T.E. 02-49, WMECO has a debt to total capitalization
3 ratio of approximately 41% for rate-making purposes compared to a debt to total
4 capitalization ratio of 53% for rating-agency purposes, as of June 30, 2003.

5
6 **Q. How is this misalignment adversely affecting WMECO?**

7 A. Prior to the restructuring process, this difference in methodology did not create any
8 material discrepancies because WMECO's overall rate base was much larger than it
9 currently is and it was able to maintain rate-making and rating-agency capitalization
10 structures that were generally equal on a return on equity basis. However, now that
11 WMECO has divested of its generation assets and its remaining rate base is much smaller
12 than it was in the past, the different treatments of the PSNF liability results in a sizable
13 mismatch between the rate-making and rating-agency capitalization ratios. Specifically,
14 the rate-making capital structure, assuming the issuance of long-term debt approved in
15 D.T.E. 02-49, reflects a debt to total capitalization ratio that is too low (41%) and not
16 reflective of the proper capitalization for WMECO. Total debt as a percentage of total
17 capitalization for WMECO is targeted in the 55% to 60% range, consistent with levels
18 needed to maintain current BBB+/A3 senior unsecured credit ratings.

19
20 **Q. Please describe how aligning the rate-making capitalization and rating-agency**
21 **capitalization will benefit WMECO.**

22 A. As I testified in D.T.E. 02-49, WMECO is in the midst of transitioning to a

1 transmission and distribution company and believes it is necessary to correct the
2 capitalization mismatch by issuing debt to fund a trust. This transaction will move
3 WMECO closer to the completion of the restructuring process and start to realign its
4 capital structures to a more appropriate debt/equity relationship. Accordingly, WMECO's
5 rate-making debt to total capitalization ratio would shift from approximately 41% to 50%,
6 a ratio more appropriately aligned with the 53% rating-agency debt to total capitalization
7 ratio.

8 This realignment is financially important to WMECO because its current rates
9 reflect an equity investment that is significantly lower than its actual equity ratio. In
10 addition, WMECO is providing customers with a "credit" for any restructuring-related rate
11 base deductions based on its actual capital structure. Financing the PSNF liability with
12 debt will reduce the return applied to the rate base deductions. Likewise, for rate-making
13 purposes, the PSNF liability will no longer be a reduction to rate base and the debt will be
14 included in the cost of capital calculation.

15
16 **Q. Are the benefits to customers of financing the PSNF liability the same as you**
17 **indicated in D.T.E. 02-49?**

18 A. Yes. This transaction will decrease WMECO's weighted average cost of capital,
19 thereby minimizing future charges to WMECO's customers resulting from reduced
20 revenue requirements.

1 **Q. How does WMECO propose to proceed to finance its PSNF liability?**

2 A. As I testified to in D.T.E. 02-49, an irrevocable trust fund will be established and
3 will be funded with proceeds of the debt issuance with WMECO as the beneficiary and
4 owner of the funds and Northeast Utilities Service Company (“NUSCO”), the service
5 company affiliate of WMECO, acting as agent on behalf of WMECO for the purpose of
6 administering the trust agreement.

7
8 **Q. Are the details of the trust the same as you testified to in D.T.E. 02-49?**

9 A. Yes. The proceeds of the debt issuance (exclusive of the portion needed to pay
10 issuance expenses) will be used to fund a trust for the purpose of satisfying the obligation
11 to DRI for the PSNF liability. WMECO will own and NUSCO would manage the trust in
12 a similarly structured trust agreement. The liability to DRI for PSNF would remain on
13 WMECO’s balance sheet, as would the assets in the trust. The trust assets would be
14 available only to satisfy the PSNF liability to DRI and would not be available to the
15 general creditors of WMECO.

16
17 **Q. How would the rating agencies view the long-term debt and the PSNF**
18 **liability?**

19 A. As the PSNF liability would remain on WMECO’s financial statements, and new
20 debt would also be included in the financial statements, WMECO’s long term debt and
21 total capitalization as calculated by the rating agencies may increase. However, WMECO
22 would also own the trust, which was funded with proceeds of the debt issuance equal to

1 the amount of the PSNF liability. The trust would be recorded in the asset account “other
2 deferred debits” on WMECO’s balance sheet. Based on the structure of the trust, which
3 would only be available to fund the payment to DRI for the PSNF liability, investment
4 management fees and trustee expenses, it is our view that the rating agencies would also
5 recognize the trust assets as offsetting the PSNF liability to DRI. Whether or not the
6 liability is included in their debt and capitalization calculations, the issuance of the debt
7 would not impact WMECO’s credit rating. This is exactly the same situation to which I
8 testified in D.T.E. 02-49.

9
10 **Q. Has WMECO discussed this new structure with the rating agencies?**

11 A. Yes. WMECO has met with and has had several conversations with Standard and
12 Poor’s (“S&P”), Moody’s Investor Services (“Moody’s”), and Fitch Ratings (“Fitch”).
13 Each rating agency has reviewed the proposal put before the Department today and has
14 concluded that the issuance of debt would not impact WMECO’s credit rating, subject to
15 satisfactory review of all related documentation, including the investment policies and
16 trust agreement.

17
18 **Q. What are WMECO’s current debt ratings?**

19 A. WMECO’s current unsecured debt ratings are BBB+, A3 and BBB+ from S&P,
20 Moody’s and Fitch, respectively.

1 **Q. How would the funds in the trust be invested?**

2 A. WMECO developed draft investment policies to direct the investment of trust
3 assets. These policies will identify certain classes of approved high quality securities to
4 restrict the trust's investment direction. Additionally, the policies provide parameters
5 regarding diversification, liquidity and maturity. The investment objective is to
6 outperform, on at least a marginal basis, the rate of return required by the DOE to accrue
7 on the PSNF liability. The draft investment policy is appended to this testimony as
8 Exhibit RAS-1. This draft investment policy is the one submitted in D.T.E. 02-49.

9

10 **Q. Does WMECO have a draft trust agreement?**

11 A. Yes. WMECO has developed a draft trust agreement to govern the draft trust
12 arrangement as outlined above. The draft trust agreement is appended to this testimony as
13 Exhibit RAS-2. This draft trust agreement is the same as was provided in D.T.E. 02-49.

14

15 **Q. Have the rating agencies reviewed the draft investment policies and trust**
16 **agreement?**

17 A. The rating agencies have reviewed and are satisfied with the draft investment
18 policies and trust agreement.

19

20 **Q. Please describe the major characteristics of the trust fund.**

21 A. Investment guidelines restricting investment options will be in the trust agreement,
22 and will include only government and other high-quality obligations. WMECO would not

1 be permitted to withdraw funds from the trust and would not have the right to liquidate the
2 trust to retrieve the funds deposited with the trust, except as described below. Earnings
3 from the investments of capital in the trust would be targeted to equal or exceed the
4 required DOE accrual obligation.

5
6 **Q. What will happen if the DOE determines that it will not require a payment
7 for PSNF liabilities?**

8 A. In the event that the DOE determines that it will not require a payment from DRI
9 for WMECO's PSNF liability, the trust would be dissolved, the trustee will return the
10 funds in the trust to WMECO, and all of WMECO's liability to DRI for the PSNF would
11 be extinguished. If this event were to occur, it would be to the benefit of WMECO
12 customers, as is currently the case.

13
14 **Q. What if the DOE reduces the amount of the PSNF liability required?**

15 A. In the event that the DOE reduces the amount of the PSNF liability, as negotiated
16 by DRI (pursuant to the Millstone purchase and sale agreement) on behalf of WMECO,
17 the PSNF liability will be reduced to the settlement amount and the trustee will return the
18 additional amount in the trust that exceeds the settlement amount to WMECO. If this
19 event were to occur, it would be to the benefit of WMECO customers, as is currently the
20 case.

1 **Q. What happens if the DOE increases the amount of PSNF liability required?**

2 A. In the event that the DOE increases the amount that is required, any shortfall in the
3 amount in the trust as compared to the higher DOE required amount will be the obligation
4 of WMECO customers, as is currently the case. However, as mentioned below, the
5 likelihood of such a shortfall is remote.

6

7 **Q. What if the trust earns more than what is required to be paid to the DOE?**

8 A. At the time that the trust is dissolved and the required funds are remitted to DRI for
9 payment to the DOE, any incremental amount earned by the trust above the DOE required
10 amount will be to the benefit of WMECO customers.

11

12 **Q. What if the trust earns less than what is required to be paid to the DOE?**

13 A. At the time that the trust is dissolved and the required funds are remitted to DRI for
14 payment to the DOE, any shortfall in the amount earned by the trust as compared to the
15 DOE required amount will be the obligation of WMECO customers.

16

17 **Q. Is there any circumstance in which WMECO would be required to pay**
18 **additional funds to the DOE (through DRI) for its PSNF liability?**

19 A. There is no expectation that WMECO would be required to pay additional funds to
20 the DOE for this PSNF liability. This pre-1983 liability to the DOE, including the accrual
21 of interest on the liability at the 3-month Treasury bill yield, was pre-determined under the
22 Nuclear Waste Policy Act of 1982.

1 **Q. Has the nature of the proposed trust changed in any respect from that**
2 **proposed by WMECO in D.T.E. 02-49?**

3 A. No.

4

5 **III. EXPLANATION OF FINANCING CONSIDERATIONS**

6 **Q. Please describe the long-term debt that WMECO is proposing to issue to**
7 **refinance the PSNF liability.**

8 A. To provide the company with the most financing flexibility, WMECO proposes to
9 issue and sell up to \$52 million in aggregate principal amount of Long-term Debt with a
10 maturity ranging from 3 to 30 years. The long-term debt may be in the form of secured or
11 unsecured notes, carry either a fixed or floating interest rate, be either insured or
12 uninsured, and be distributed to either retail or institutional investors.

13

14 **Q. Please describe how the financing proceeds will be used?**

15 A. The \$52 Million in proceeds will be used to fund the previously described trust in
16 an amount equal to the then outstanding PSNF balance (up to \$51.5 Million), and to pay
17 for issuance costs (up to \$0.5 Million). Although the current PSNF balance, as of June 30,
18 2003 is approximately \$48.5 Million, this liability grows at the 3-month treasury yield.
19 Since the company is seeking approval to complete this financing at a period no later than
20 December 31, 2004, the \$51.5 Million represents an estimate of the PSNF balance as of
21 that date.

22

1 **Q. What are the primary differences between retail and institutional debt?**

2 A. Retail debt, unlike institutional debt, is primarily distributed to individual investors
3 rather than to financial institutions, is listed on the New York Stock Exchange, sells at \$25
4 par value compared to \$1,000, pays interest quarterly, can be called at par value after 3-5
5 years, and requires SEC registration.

6

7 **Q. Are there advantages to issuing retail debt as opposed to institutional?**

8 A. Depending on current market conditions there may be interest-rate advantages
9 associated with a retail debt issue compared to an institutional issue. Retail investors tend
10 to focus on absolute yield, name recognition, payment frequency, and liquidity rather than
11 on relative value and spread as compared to the institutional market and, as a result, are
12 less reactive to changes in market conditions. Consequently, retail market coupon rates
13 may be lower than those in the institutional market in a rising-rate environment.

14

15 **Q. Is there a significant difference in upfront costs between retail and**
16 **institutional debt?**

17 A. Since greater effort is required by participating managers to distribute the notes to a
18 large retail investor group (rather than a few financial institutions), underwriting fees are
19 significantly higher in the retail market (3.15% compared to 0.65%). After considering
20 both the coupon rate and underwriting fees, the all-in costs between the retail and
21 institutional markets are generally comparable, with differences attributed to the lag in the
22 responsiveness of the retail market mentioned above. WMECO will consider the market

1 conditions at the time of issuance when determining whether it will issue retail or
2 institutional debt.

3
4 **Q. Are there any other advantages to issuing retail debt as opposed to**
5 **institutional debt?**

6 A. Another potential advantage of retail debt is the ability of the issuer to call the debt
7 securities at par. Conversely, in the institutional market, the debt securities may not be
8 redeemable, or may only be redeemed at very costly make-whole rates, which are designed
9 to penalize the issuer for redeeming the debt securities prior to maturity. Additionally, the
10 call option in the retail debt reduces the refinancing risk for the debt securities since any
11 amount of the debt securities can be called at par anytime after an initial agreed-upon
12 period (typically 3-5 years). Other cost advantages may exist by securing the debt
13 securities with either a mortgage or negative pledge, or by obtaining financial assurance
14 from an AAA-rated insurance provider.

15
16 **Q. Please describe the advantages associated with securing the debt with a**
17 **mortgage or obtaining insurance.**

18 A. With both alternatives, security holders are willing to accept a lower coupon
19 payment in exchange for additional security. WMECO will consider the market
20 conditions at the time of issuance when determining whether it is advantageous to secure
21 the debt securities with a mortgage or negative pledge and/or obtain insurance.

1 **Q. How are market conditions evaluated?**

2 A. Market conditions, which consist of various economic and industry factors,
3 determine the coupon rate of debt by influencing treasury yields and credit spreads.
4 WMECO utilizes several resources to assess market conditions. First, WMECO draws on
5 the knowledge and experience of its investment banks to estimate the pricing of available
6 financing alternatives. Second WMECO analyzes data from various financial and industry
7 sources to draw its own conclusions regarding credit spreads, interest rates, issuance costs,
8 and other economic factors.

9

10 **Q. What is the estimated coupon rate for the proposed issuance given current**
11 **market conditions?**

12 A. Based upon current market conditions, the estimated coupon rates range from
13 3.20% (3-year institutional unsecured debt) to 6.60% (30-year institutional unsecured
14 debt). These rates reflect credit spreads ranging from 85 to 130 basis points, given 3-year
15 and 30-year treasury rates (2.35% and 5.30%, respectively). In addition to market
16 conditions, estimates depend on the maturity, security and/or financial assurance and
17 whether the debt is offered to institutional or retail investors.

1 **Q. What other fees are associated with the issuance?**

2 A. Notwithstanding the various financing alternatives provided within this
3 application, the following table lists the expected fees associated with the most probable
4 financing structure, which is a 10-year unsecured institutional issuance:

Fee	Amount
Underwriting Fees (1)	\$338,000
Rating Agencies	\$66,000
Legal	\$35,000
Printing/Misc.	\$23,000
Total	\$462,000

5 (1) Underwriting fees are based upon a 0.65% commission on a \$52,000,000 issuance.

6

7 **Q. Are the financing considerations you present in this Section III the same as**
8 **those presented in your testimony in D.T.E. 02-49?**

9 A. Yes.

10

11 **Q. When does WMECO need the Department approval to issue long-term debt?**

12 A. WMECO respectfully requests that the Department issue an order approving the
13 issuance of long-term debt as soon as possible to capitalize on the current historically low
14 interest rate environment.

15

16 **IV. EXEMPTION FROM M.G.L. C. 164 §§15 AND 15A**

17 **Q. Why is WMECO seeking an exemption from M.G.L. C. 164 §§15?**

18 A. WMECO respectfully requests that the Department waive the requirement in
19 M.G.L. c. 164 §15, which would otherwise require WMECO to invite proposals for the
20 Long-term Debt issuance advertisements in certain newspapers specified in that section. It

1 would be in the public interest for the Department to grant such an exemption because
2 there is already a measure of competition in the Company's solicitation of various
3 investment bankers with broad experience in the debt markets and access to potential
4 investors. In addition, an exemption is in the public interest because such an exemption
5 provides WMECO with the ability to respond quickly to changes in market conditions and
6 to facilitate the use of a variety of pricing mechanisms and take full advantage of market
7 conditions and obtain maximum attention from potential investors. Requiring competitive
8 bidding pursuant to §15 could jeopardize the flexibility sought in these transactions, and
9 ultimately jeopardize the financial benefits available to customers under this placement
10 process. Therefore, the benefits one would expect from publication and competitive
11 bidding are largely inapplicable in this case and such a process is not likely to yield a more
12 favorable interest rate or more favorable terms on the Long-term Debt, but would likely
13 cause the issuance of the Long-term Debt to be more expensive.

14
15 **Q. Why is WMECO seeking an exemption from M.G.L. C. 164 §§15A?**

16 A. WMECO also requests an exemption from the par value requirements of M.G.L. c.
17 164, § 15A in connection with the issuance of the long-term debt. Such an exemption is in
18 the public interest because market conditions may make it difficult for WMECO to price
19 all of its debt at par value and simultaneously offer an acceptable coupon rate to
20 prospective buyers. Investors rely on such discounts as a means to refine the price
21 structure of a debt instrument to achieve a desired interest rate. Consequently, a discount
22 provision offers enhanced flexibility that results in placing issuances with prospective

1 investors at a market-based interest rate. In addition, an exemption from the requirements
2 of M.G.L. c. 164 § 15A is in the public interest because it will enhance WMECO's
3 flexibility in entering the market quickly to take advantage of prevailing interest rates.
4 Such flexibility could benefit WMECO's customers in the form of lower interest rates and
5 a lower cost of capital.

6

7 **V. NET PLANT TEST**

8 **Q. Can you address WMECO's compliance with the Department's net plant test**
9 **under the use of proceeds proposal set forth in this testimony?**

10 A. Yes. WMECO meets the Department's net plant test. As of June 30, 2003,
11 WMECO's net utility plant, utility plant less accumulated depreciation and less
12 construction work in progress, \$398,514,000, is equal to or in excess of the sum of its
13 outstanding stock (common and preferred, not including retained earnings) and long-term
14 debt (not including the PSNF liability) of \$134,696,000 (the total outstanding stock and
15 long-term debt increases to \$189,196,000 when including the effects of the yet to be issued
16 \$55 Million of long-term debt authorized in D.T.E. 02-49). After giving effect to the
17 issuance long-term debt to refinance WMECO's PSNF obligations, as proposed in this
18 petition, WMECO will still meet the Department's net plant test as the sum of its
19 outstanding stock and long-term debt will be \$241,196,000.

20

21 **Q. Does this conclude your testimony?**

22 A. Yes, it does.